

***United States Court of Appeals
for the Second Circuit***



**BRIEF FOR
APPELLANT**

77-5028/31

To be argued by
RICHARD S. TODER

United States Court of Appeals FOR THE SECOND CIRCUIT

In the Matter of
THE DUPLAN CORPORATION
DUPLAN FABRICS, INC.,
Debtors.

CHEMICAL BANK, THE FIRST NATIONAL BANK OF CHICAGO,
NORTH CAROLINA NATIONAL BANK AND SECURITY PACIFIC
NATIONAL BANK,

Appellants,

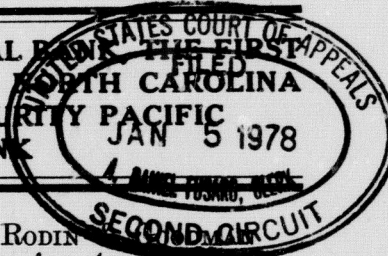
THE ROCHESTER JOINT BOARD AMALGAMATED CLOTHING
WORKERS OF AMERICA, AFL-CIO,

Appellee,

ALFRED P. SLANER, as Trustee in Reorganization of
The Duplan Corporation, and DUPLAN FABRICS, INC.,
Debtors,

Appellee.

BRIEF OF APPELLANTS CHEMICAL BANK, THE FIRST
NATIONAL BANK OF CHICAGO, NORTH CAROLINA
NATIONAL BANK AND SECURITY PACIFIC
NATIONAL BANK



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Appellants,

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**BRIEF OF APPELLANTS CHEMICAL BANK, THE FIRST
NATIONAL BANK OF CHICAGO, NORTH CAROLINA
NATIONAL BANK AND SECURITY PACIFIC
NATIONAL BANK**

Preliminary Statement

The Chemical Bank, North Carolina National Bank, The First National Bank of Chicago and Security Pacific National Bank (the "Secured Bank Lenders") appeal from so much of an order by the Honorable Kevin T. Duffy, United States District Judge for the Southern District of New York, dated October 5, 1977 and entered by the Clerk of the Court on October 12, 1977, as approved and authorized Alfred P. Slaner, the Chapter X Trustee (the "Reorganization Trustee") of The Duplan Corporation ("Du-

plan") to enter into Article XV D (the "Article") of a collective bargaining agreement (the "Agreement") between Rochester Button Company ("Rochester") a division of Duplan, and the Rochester Joint Board Amalgamated Clothing Workers of America, AFL-CIO (the "Union"). It is the Secured Bank Lenders' position that the District Judge's order must be reversed since the Court refused to permit an evidentiary hearing to be held and decided this important matter on a totally inadequate record.

The United States Trust Company of New York, the Successor Indenture Trustee of Duplan's 5½% Convertible Subordinated Debentures, due February 1, 1994 (the "Indenture Trustee") appeals from the same order.

Issues Presented

1. Did the District Court commit reversible error in refusing to hold an evidentiary hearing with respect to the proposed Article where (i) the Article was conceded by the Reorganization Trustee to be onerous and burdensome, (ii) the Article created a contingent liability to the estate of in excess of \$6,000,000, and (iii) the hearing was expressly requested by the Secured Bank Lenders and the Indenture Trustee representing approximately 80% in amount of the estate's creditors?

2. Did the District Court abuse its discretion by failing to exercise sound business judgment when it approved the aforementioned Article on the basis of a wholly inadequate record?

Statement of the Case

A. The Nature of the Case

This is a reorganization proceeding brought under Chapter X of the Bankruptcy Act as amended (the "Act") (11 U.S.C. §§ 501-676). On August 31, 1976, Duplan and

Duplan Fabrics, Inc. filed a petition for an arrangement under Chapter XI of the Act. On October 5, 1976, on motion of the Securities and Exchange Commission, the cases were transferred to Chapter X of the Act and on October 6, 1976, Alfred P. Slaner was appointed Reorganization Trustee. The two cases were consolidated for procedural purposes by order dated November 1, 1976.

There are two major milestones in the course of a Chapter X proceeding: the writing of a report pursuant to Section 167 of the Act (11 U.S.C. § 567) with respect to the reorganizability of the debtor and the proposal of a plan of reorganization. Neither of these milestones has been reached in this proceeding.

B. The Prior Proceedings

On June 30, 1977, the Reorganization Trustee filed a notice for the settlement of a proposed order with accompanying application seeking approval of and authorization to enter into the Agreement (Joint Appendix, pp. 22-86).^{*} The Agreement contained a severance pay provision, Article XV D (A74-5) which created a potential obligation of \$6,400,000 in the event the Rochester operations were liquidated (A103, 118, 122-3). Thereafter, a counter-proposed order and affidavit of Malcolm Hood, sworn to on July 13, 1977, were submitted by the Indenture Trustee in opposition to the Article (A87-94).

On September 2, 1977, Judge Duffy signed an order tentatively approving the Agreement with the exception of the Article and scheduling a hearing on the Agreement on September 27, 1977. Thereafter, the Secured Bank Lenders submitted an affidavit by James D. Glass, Esq., sworn to on September 24, 1977, also opposing the Article (A101-17). The basis of the objections by both the Indenture Trustee and the Secured Bank Lenders was that the Article was

^{*} References to the Joint Appendix will henceforth be cited as "A" followed by the applicable page or pages.

onerous and burdensome and could well jeopardize any successful reorganization.*

On September 27, 1977, counsel for the various parties appeared before Judge Duffy. No testimony was adduced in favor of the Article and the joint request of the Secured Bank Lenders and the Indenture Trustee to adjourn the hearing to permit them to take the testimony of the Union representative who had negotiated the Agreement was denied by the Court (A129-35). Instead, following oral argument, the Court, without any discussion as to the reasons for its decision, granted the application of the Reorganization Trustee to approve the Article (A135). At a subsequent appearance before the Court on October 19, 1977 with respect to other matters, the Court refused the Indenture Trustee's renewed request that the Court reopen the original hearing to take the testimony of both the Reorganization Trustee and the Union representative (A139-41). On October 12, 1977, the Clerk of the Court entered an order made by Judge Duffy dated October 5, 1977, approving the Agreement, including the Article.

On October 31, 1977, the Secured Bank Lenders filed a Notice of Appeal from so much of Judge Duffy's order as approved the Article and on November 14, 1977, the Indenture Trustee filed a similar Amended Notice of Appeal.

Statement of Facts

The Agreement is a collective bargaining agreement between Rochester and the Union covering employees at three plants in Rochester, Wellsville and Akron, New York for

* The Secured Bank Lenders are creditors of Duplan in the unpaid principal amount of approximately \$38,000,000. The value of the collateral securing this indebtedness is substantially less than that amount (A102). The Indenture Trustee represents an indebtedness of Duplan in the unpaid principal amount of approximately \$19,200,000. Together they comprise approximately 80% in amount of the creditors of Duplan.

the period June 1, 1977 to September 30, 1980 (A27-8). It was negotiated by representatives of the Reorganization Trustee and the Union and provided that it was subject to approval of the Reorganization Court (A28, 85). The Article, which relates to severance pay and is the subject of the appeals, provides:

"D. In the event that operations of the employer are liquidated at the Rochester, Wellsville or Akron, New York plants during the term of this agreement, the following provisions shall apply:

1. If the operations of the employer are liquidated prior to February 1, 1979 then and in that event, the employer agrees to pay each employee separated as the result of such liquidation, a sum equal to the amount he would have been paid had he not been so separated, said sum to be computed on the basis of an average work week of forty (40) hours for the remainder of the contract period.

2. If liquidation occurs on or after February 1, 1979, the parties shall negotiate the amount of severance pay due each employee. In the event that the Employer and the Union are unable to mutually agree upon the amount of severance pay to be paid to such employees, then and in that event, the amount of the severance pay shall be determined by an arbitrator selected from a panel proposed by the American Arbitration Association in accordance with the Association's rules and procedures and the determination of the Arbitrator shall be final and binding.

In establishing the amount of the severance pay due each employee, the Arbitrator shall consider the age and length of service of each employee and the employee's above stated intention not to liquidate its Rochester, Wellsville and Akron, New York Facilities." (A74-5)

It was conceded by the Reorganization Trustee's counsel that the Article was both "onerous" and "burdensome" (A128).

The Article is the same as that contained in a prior collective bargaining agreement between Rochester and the Union which expired on May 31, 1977. The prior collective bargaining agreement was negotiated during the year when Rochester was operating at peak profits of \$3,201,000 per annum (A28, 33). Since then, Duplan has been forced to seek protection under the Act and Rochester has experienced a dramatic downturn in its profitability. At the time of the hearing, the latest statement for the ten-month period ended July 31, 1977 showed that Rochester's net profits had dropped to \$141,000 on \$13,906,000 of sales (A113). That statement also showed that during the same period Duplan and its subsidiaries operated at an overall consolidated loss of \$355,000 (A112).

In the event that economic conditions forced the closing of the Rochester plants, the employees of the Union at these plants would be entitled to severance pay in accordance with the provisions of the Article. The Trustee prepared a schedule of Comparative Costs of the Article to the estate if Rochester were liquidated on the below dates (A118):

<i>Date of Liquidation</i>	<i>Amount of Séverance Pay</i>
October 1, 1977	\$6,387,000
April 1, 1978	5,644,000
October 1, 1978	4,903,000*
February 1, 1979	4,086,000*
February 1, 1979- September 30, 1980	Subject to Arbitration

* Includes maximum cost of living increase (\$.15 per hour).

This potential obligation would be an administration expense which would be entitled to priority over the claims of general unsecured creditors.

Despite the marginal nature of the Rochester operation, the Reorganization Trustee submitted no operating projections during the period of the Agreement with respect to Rochester or any opinion as to the reorganizability of Duplan. The Reorganization Trustee's counsel merely expressed "a hope in the trustee's mind that there will be a resurgence in the business" of Rochester due to the reemployment of prior management (A131).

ARGUMENT

POINT I

The District Court committed reversible error in approving the Article since it refused to conduct an evidentiary hearing where (i) the Article was conceded by the Reorganization Trustee to be onerous and burdensome, (ii) the Article created a contingent liability to the estate of in excess of \$6,000,000 and (iii) the hearing was requested by creditors' representing approximately 80% in amount of the estate's creditors.

Close judicial supervision of the entire reorganization proceedings is a major tenet of Chapter X. *Texas Importing Company v. Banco Popular de Puerto Rico*, 360 F.2d 582 (5th Cir. 1966). That supervision requires that the Court and not merely the Reorganization Trustee give consideration to matters which have an important bearing on the financial status of the debtor.

In the instant case, there are several crucial facts which are uncontroverted. The Article which is the subject of the appeal was conceded by the Reorganization Trustee's

counsel to be burdensome and onerous (A128). The potential liability to the estate on account of severance pay in the event that business conditions necessitated the closing of the Rochester plants was in excess of six million dollars (A103, 118, 122-3). And operations at the Rochester plants had deteriorated to the point that they were earning only a marginal profit and had, at best, a clouded future (A113, 123, 131). It is with these circumstances in mind that the District Court's actions must be judged.

The Agreement provided that it was subject to the approval of the Reorganization Court (A28, 85). In view of the significance of the Agreement, and especially the Article, to the reorganization proceedings, this was hardly surprising. Section 206 of the Act (11 U.S.C. § 606) and Rule 10-210 of the Chapter X Rules provide that the Indenture Trustee and any creditor shall have the right to be heard on all matters arising in a proceeding under this Chapter. By refusing to hold an evidentiary hearing with respect to this matter, the Court entirely eviscerated the requirement that a hearing be held. Such refusal, in and of itself, constitutes reversible error. *Matter of Tilco, Inc.*, 558 F.2d 1369 (10th Cir. 1977); *B.J.M. Realty Corporation v. Ruggieri*, 326 F.2d 281 (2d Cir. 1964); *Wolf v. Nazareth Enterprises, Inc.*, 303 F.2d 152 (2d Cir. 1962).

The case of *Wolf v. Nazareth Enterprises, Inc.*, *supra*, is particularly instructive. There, the debtor in a Chapter X proceeding sought, *inter alia*, to compromise certain claims between the debtor and another. On the return date of the hearing in the district court, counsel for a creditor sought to adjourn the hearing so as to allow him to prepare to cross-examine witnesses. The adjournment was refused by the district judge and the compromise approved. On appeal, the Court of Appeals reversed because of the inadequacy of the hearing. As Judge Smith held:

"Judge Sugarman was quite correct in his prediction that we would view with disfavor his refusing to permit

appellant adequate opportunity to prepare himself to cross-examine the witnesses and fully present his views. In a situation such as the one at bar, it is incumbent upon the trial judge to exercise an 'informed independent judgment' in passing on the compromise. [citations omitted]. In order to exercise such judgment in a judicious manner it is obviously necessary that all interested parties be heard." 303 F.2d at 154.

In *Matter of Tilco, Inc., supra*, the reorganization trustee in a Chapter X proceeding sought to reject executory contracts for the sale of natural gas by a subsidiary of the debtor to Mobil Oil Corporation. The contracts had been profitable to the debtor in the past and on that basis, without holding an evidentiary hearing, the district court denied the trustee's motion to reject. The Court of Appeals for the Tenth Circuit reversed:

"The difficulty is that the court denied the Trustee's application because the contracts were income productive. *The court acted without any hearing on the benefits or detriments to the bankruptcy estate that might result from contract rejection. The Trustee was entitled to an evidentiary hearing. The court, not the Trustee, must apply the 'business judgment' test. It cannot do so without presentation of the facts and the making of findings subject to appellate review.*" (Emphasis supplied). 558 F.2d at 1373.

To the same effect, *B.J.M. Realty Corporation v. Ruggieri*, 326 F.2d 281, 284 (2d Cir. 1964), where this Court reversed the denial by the district court of a motion by a landlord to compel a debtor to vacate leased premises and ordered a full evidentiary hearing to be held.

Nor was the failure of the district judge in the instant case to hold a complete hearing a mere procedural defect. The potential significance of the Article on the reorganiza-

tion proceedings has already been adverted to. Furthermore, testimony might well have demonstrated both that the Article was improvident and that a modification of the Article would not have adverse consequences.

The Section 167 report has not yet been filed by the Reorganization Trustee and, accordingly, his opinions as to the viability of Duplan, either in its entirety or in part, are not known. Rochester has recently suffered substantial economic reverses (A33, 113, 123, 131) and its prognosis for the future is uncertain. The Reorganization Trustee submitted no financial projections for Rochester in connection with his application to approve the Agreement, including the Article. Neither did the Reorganization Trustee testify with respect thereto nor does the application submitted by him discuss this matter. Indeed, the sole reference in the record to this crucial aspect of the application is a statement by counsel for the Reorganization Trustee to the effect that although "there was a problem" with respect to profitability, there is a "hope in the trustee's mind that there will be a resurgence in the business" (A131).

Surely, this is not a sufficient basis on which a potential administration liability of in excess of \$6,000,000 can be created.

Both the Indenture Trustee and the Secured Bank Lenders wanted to cross-examine the representatives of the Union who had negotiated the Article. It was submitted by counsel for the Secured Bank Lenders that the purpose of the Union's insistence on the Article was principally to prevent a so-called "runaway shop"; that is, a relocation of Rochester to an area where the present employees would no longer be employed, rather than to protect against a final termination of the business due to economic conditions (A105, 125, 129-30, 131-2). If this were established, then the specter raised by counsel for the Reorganization Trustee

tee of a ruinous strike if the Article had not been adopted (A128) could be disproved. Since the attorney for the Union, present at the hearing, had no first hand knowledge of the negotiations (A130), exploration of this area at the hearing was not possible. Testimony from the Union representatives as to whether the severance provision is customary in the industry would also be important to the Court in making its determination.

While the District Judge conducted a "hearing" on September 27, 1977, the ground rules established by the Court prevented any meaningful inquiry into the issues raised by the Reorganization Trustee's application. The abbreviated non-evidentiary hearing was similar to those which have been condemned by the courts including this Court. For this reason, the decision by Judge Duffy approving the Article must be reversed and the case remanded for a full testimonial hearing.

POINT II

The District Court abused its discretion by failing to exercise sound business judgment when it approved the Article on the basis of a wholly inadequate record.

It was incumbent upon the district judge to exercise his "informed independent judgment" in passing on whether to approve the Article. *Matter of Tilco, Inc.*, 558 F.2d 1369, 1373 (10th Cir. 1977); *Wolf v. Nazareth Enterprises, Inc.*, 303 F.2d 152, 154 (2d Cir. 1962); *In re Long Island Properties, Inc.*, 125 F.2d 206, 208 (2d Cir. 1942). If that is done by the district court, then the appellate court will affirm the lower court's judgment absent an abuse of discretion. *Matter of Tilco, Inc., supra*.

However, in the case at bar, the District Judge did not have available to him the necessary data on which to decide this matter. By refusing the creditors' requests to hold an evidentiary hearing, the Court prevented the facts from being presented and thus made its determination on the

basis of an incomplete and inadequate record. Such action mandates a reversal and remand. *Matter of Tilco, Inc., supra*; *Wolf v. Nazareth Enterprises, Inc., supra*.

Indeed, even the abbreviated record in this case demonstrates that the lower court erred in approving the Article. It was the Reorganization Trustee as the moving party who had the burden of establishing that the Article was in the best interests of the estate. Not only did he fail to do so, but his counsel conceded that the Article was both "burdensome and onerous" (A128). These are the very findings that permit the rejection of executory contracts including collective bargaining agreements. *Brotherhood of Railway, etc. v. REA Express, Inc.*, 523 F.2d 164 (2d Cir.), *cert. denied*, 423 U.S. 1017 (1975); *Shopmen's Loc. U. No. 455, etc. v. Kevin Steel Prod. Inc.*, 519 F.2d 698 (2d Cir. 1975).

Counsel for the Reorganization Trustee's *ipse dixit* statement that there was no alternative to the Article except a strike (A128) is entitled to no weight at all since there was no evidence presented on this or any other issue raised by the Reorganization Trustee's application. In view of the present marginal nature of the Rochester operations, it was indispensable that the Reorganization Trustee demonstrate that a liquidation of the Rochester plants was not likely. This was not done and the failure to do so is fatal to the Reorganization Trustee's position.

It is respectfully submitted that the record before the District Court was so inadequate as to prevent that Court from making a reasoned judgment on the issues. Moreover, in granting the Reorganization Trustee's application to approve the Article, Judge Duffy entirely failed to make any findings of fact or disclose the basis for his decision. After argument the Court merely said:

"I have read the papers. The motion is granted, and that is all there is to it." (A135).

On October 19, 1977, in denying an application by the Indenture Trustee to reopen the proceedings to permit the taking of testimony, the Court explained its ruling by noting that (i) there was no indication that the Union contract was not negotiated in good faith and (ii) the Article was a carryover provision from the previous collective bargaining agreement between the parties. On this basis, the Court concluded:

"I believe I said that I thought that the trustee was acting properly, and under the circumstances I see no reason for a hearing with testimony and a record to be made in this situation." (A141).

Respectfully, the rationale advanced by the District Judge does not withstand scrutiny. Whether or not the Reorganization Trustee negotiated this Article in good faith is irrelevant. The issue is whether the Article as negotiated is, as has been conceded, so burdensome and onerous as to bar its approval. That the prior collective bargaining agreement between the parties has an identical severance pay provision is hardly dispositive. As has been pointed out, the prior labor agreement was executed at a time when Rochester was realizing great profits. By way of contrast, the Article is before the Court, while Duplan is in Chapter X proceedings and Rochester, a division of Duplan, has become a marginal operation.

The District Judge was required to make an independent business judgment as to whether the Article was in the best interests of the estate. In effect, the Court, by refusing to permit an evidentiary hearing, abdicated its responsibility. This Court should reverse Judge Duffy's decision and remand for further hearings.

CONCLUSION

For all of the above reasons, Judge Duffy's order dated October 5, 1977 and entered on October 12, 1977 should be reversed.

Dated: New York, New York
January 5, 1978

Respectfully submitted,

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The First National Bank of
Chicago
North Carolina National Bank
and
Security Pacific National Bank
750 Third Avenue
New York, New York 10017
(212) 682-6900

Of Counsel

RICHARD S. TODER
RICHARD A. GERARD



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CAROLINA NATIONAL BANK AND SECURITY PACIFIC NATIONAL BANK,

Appellants,

UNITED STATES TRUST COMPANY OF NEW YORK, Successor Indenture Trustee
for the 5½% Subordinated Debentures of The Duplan Corporation, due February 1, 1994,

Appellant,

THE ROCHESTER JOINT BOARD AMALGAMATED CLOTHING
WORKERS OF AMERICA, AFL-CIO,

ALFRED P. SLANER, REORGANIZATION TRUSTEE,

Appellee,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

State of New York,
County of New York,
City of New York—ss.:

DAVID F. WILSON

being duly sworn, deposes

and says that he is over the age of 18 years. That on the 5th
day of January, 1978 he served two copies of the
Brief of Appellants, Chemical Bank, et al., on
Chamberlain, D'Amanda, Bauman, Chatman & Oppenheimer

the attorneys for the Appellee, Rochester Joint Board
by depositing the same, properly enclosed in a securely sealed
post-paid wrapper, in a Branch Post Office regularly maintained
by the Government of the United States at 90 Church Street, Borough
of Manhattan, City of New York, directed to said attorneys at
No. 1100 Cross Roads Building, 2 Main Street East, Rochester () N. Y.,
that being the address designated by them for that purpose upon
the preceding papers in this action.

David F. Wilson
.....

Sworn to before me this

5th day of January, 1978.

Courtney J. Brown
COURTNEY J. BROWN

Notary Public, State of New York

No. 31-5472920

Qualified in New York County

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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ALFRED P. SLANER, REORGANIZATION TRUSTEE,

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County of New York,
City of New York—ss.:

DAVID F. WILSON, being duly sworn, deposes
and says that he is over the age of 18 years. That on the 5th
day of January, 1978, he served two copies of
Brief of Appellants, Chemical Bank et al. on
Shea Gould Climenko & Casey, Esqs., the attorney s
for Appellee, Reorganization Trustee
by delivering to and leaving same with a proper person in charge of
their office at 330 Madison Avenue
in the Borough of Manhattan, City of New York, between
the usual business hours of said day.

David F. Wilson

Sworn to before me this

5th day of January, 1978.

Courtney Brown

COURTNEY L. BROWN
Notary Public, State of New York
No. 11672020
Qualified in New York County
Commission Expires March 30, 1978

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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THE DUPLAN CORPORATION, DUPLAN FABRICS, INC.,

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for the 5½% Subordinated Debentures of The Duplan Corporation, due February 1, 1994,

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Appellee,

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DAVID F. WILSON, being duly sworn, deposes
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Jerome Feller, Esq., the attorney
for Securities and Exchange Commission
by delivering to and leaving same with a proper person in charge of
his office at 26 Federal Plaza
in the Borough of Manhattan, City of New York, between
the usual business hours of said day.

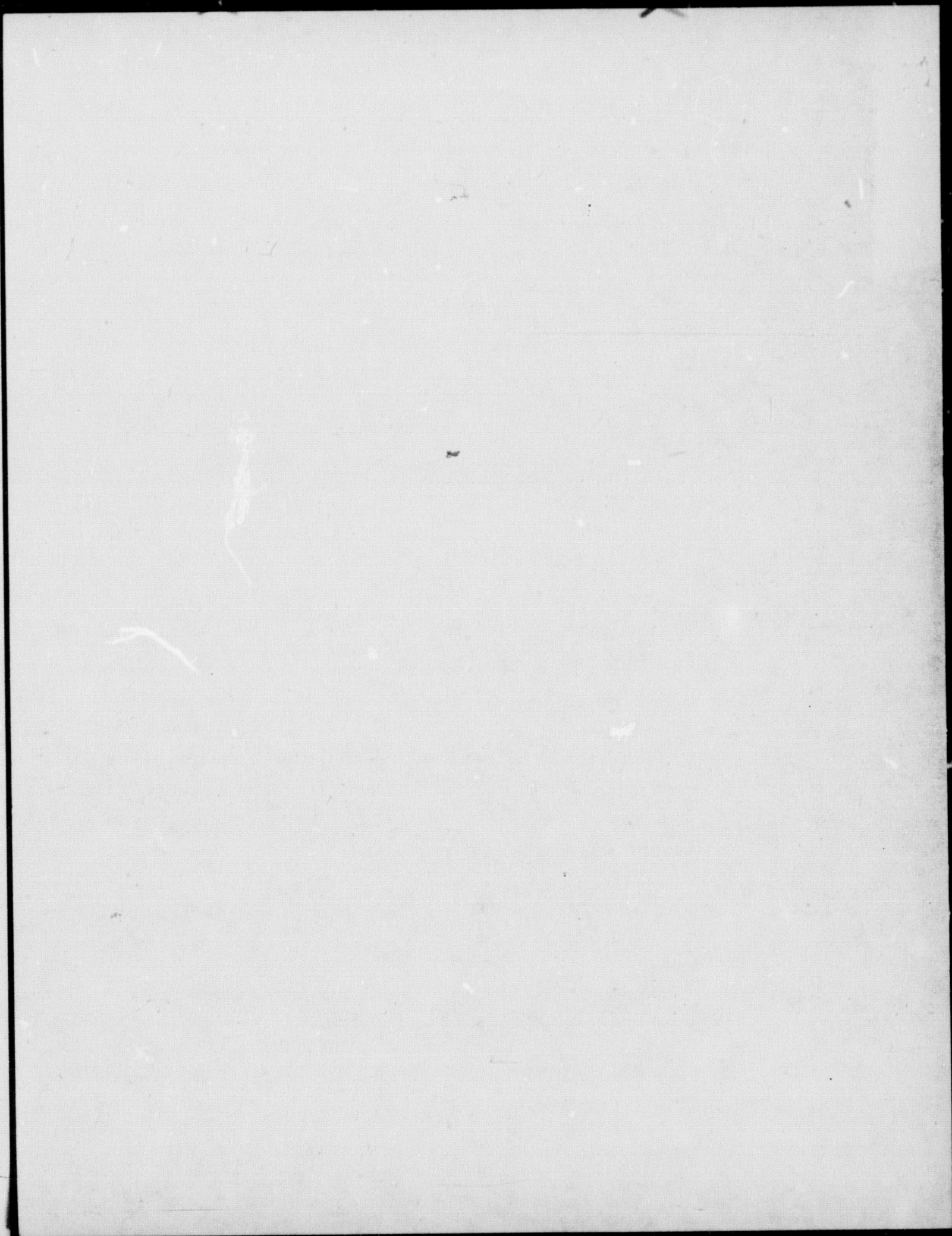
David F. Wilson
.....

Sworn to before me this

5th day of January, 1978.

Courtney J. Brown

COURTNEY J. BROWN
Notary Public, State of New York
No. 31-47793
Qualified in New York County
Commission Expires March 30, 1978



Aug
1

Due and timely service of Two copies
of the within BRIEF is hereby

admitted this 5TH day of JANUARY 1978.

Wm. M. Mallory
Col. D. M. Hall
James C. Campbell
.....
Attorneys for APPELLANT
UNITED STATES TRUST COMPANY